

GENERAL ASSEMBLY OF NORTH CAROLINA

Session 2013

Legislative Fiscal Note

BILL NUMBER: House Bill 82 (First Edition)

SHORT TITLE: IRC Update.

SPONSOR(S): Representative Howard

| FISCAL IMPACT (\$ in millions) | | | | | |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|
| State Impact | FY 2012-13 | FY 2013-14 | FY 2014-15 | FY 2015-16 | FY 2016-17 |
| General Fund Revenues: | | | | | |
| Decouple from Bonus depreciation | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Decouple from Section 179 expensing | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Repeal limitation on itemized deductions for AGI below a certain amount | (1.0) | (3.0) | (3.0) | (3.0) | (4.0) |
| Enhancements to earned income tax credit. Reduce credit percentage for 2013 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Tuition Expense. Decouple for 2013 | (3.0) | 0.0 | 0.0 | 0.0 | 0.0 |
| Student Loan Interest Deduction | (3.0) | (6.0) | (6.0) | (6.0) | (7.0) |
| Income Exclusion for Employer-Provided Educational Assistance | (3.0) | (6.0) | (7.0) | (7.0) | (8.0) |
| 15 year depreciation schedule for leasehold, restaurant, and retail improvements | (2.0) | (3.0) | (3.0) | (3.0) | (3.0) |
| Enhancements to adoption tax credit. Reduce credit percentage for 2013 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Enhancements to work opportunity tax credit. Reduce credit percentage for 2013 | (1.0) | 0.0 | 0.0 | 0.0 | 0.0 |
| Allow mortgage insurance premium deduction as interest. Decouple for 2013 | (5.0) | 0.0 | 0.0 | 0.0 | 0.0 |
| Income exclusion for cancellation of residence indebtedness. Decouple for 2013 | (2.0) | 0.0 | 0.0 | 0.0 | 0.0 |
| Tax free distribution from IRAs to charity for individuals age 70.5 or older. Decouple for 2013 | (4.0) | 0.0 | 0.0 | 0.0 | 0.0 |
| NET STATE IMPACT | (\$24.0) | (\$18.0) | (\$19.0) | (\$19.0) | (\$22.0) |
| PRINCIPAL DEPARTMENT(S) & PROGRAM(S) AFFECTED: Department of Revenue | | | | | |
| EFFECTIVE DATE: Various effective dates apply. See bill for details. | | | | | |
| TECHNICAL CONSIDERATIONS: None | | | | | |

BILL SUMMARY:

House Bill 82 would do the following:

- Update from January 1, 2012, to January 2, 2013, the reference to the Internal Revenue Code used in determining certain State tax provisions, thereby incorporating and conforming to many of the provisions contained in the American Taxpayer Relief Act of 2012 (ATRA) to the extent North Carolina law tracks those provisions, including^[1]:
 - 15-year depreciation schedule for leasehold, restaurant, and retail property
 - Modified limitations on itemized deductions
 - Student loan interest deduction
 - Income exclusion for employer-provided educational assistance programs
- "Decouple" from ATRA enhancements or extensions to the following provisions for the 2013 tax year:
 - Bonus depreciation
 - Section 179 expensing
 - Qualified tuition and expenses deduction
 - Mortgage insurance premium as interest deduction
 - Income exclusion for discharge of residence indebtedness
 - Income exclusion for IRA distributions to charity by a person who has attained age 70.5.
- Adjust the following three tax credits that were enhanced by ATRA to achieve revenue neutrality:
 - Work Opportunity credit
 - Earned Income credit
 - Adoption credit

Source: Committee Counsel, Research Division

ASSUMPTIONS AND METHODOLOGY:

The fiscal impact to the General Fund from conformity with the Internal Revenue Code is based on the US Joint Committee on Taxation (JCT) estimates on changes to federal taxes. The methodology used begins with these JCT estimates, which are calculated by federal fiscal year. Since the federal fiscal year ends 9/30 and the state's fiscal year ends 6/30, Fiscal Research adjusts these numbers to an approximate state fiscal year tax impact. Then, the next step is to prorate the national numbers to the state impact. This adjustment involved two steps: accounting for the relative size of the state based on federal tax collections and then adjusting for the difference in federal and state marginal tax rates. Once North Carolina's share of the JCT estimates were determined, state tax liability changes were estimated and allocated to the appropriate fiscal year.

^[1]The legislation made many other changes that are not discussed in this Analysis because they either had no or minimal impact on North Carolina taxable income.

The bill decouples from bonus depreciation and enhanced Section 179 expensing and consequently, there is no fiscal impact. Specifically, the bill provides that for North Carolina purposes, the taxpayer must add back 85% of the bonus depreciation and enhanced Section 179 expense deduction in the year claimed for federal tax purposes, and then deduct 20% of this amount, plus the normal depreciation amount, over the next five years. Fiscal Research ran depreciation simulations to establish that the deduction allowed net of the add-back adjustment combined with normal depreciation results in approximately the same amount of deduction the taxpayer would otherwise be entitled to in the absence of bonus depreciation and an enhanced Section 179 deduction.

Although the bill conforms to federal enhancements of the earned income tax credit, the adoption tax credit, and the work opportunity tax credit for 2013, there is no fiscal impact associated with this conformity. Each of these North Carolina credits is a percentage of the corresponding federal credit. The bill lowers the credit percentage by an amount that offsets the fiscal impact associated with conforming to the enhancements enacted by the federal legislation. To determine that the provision would not have an impact, Fiscal Research identified the fiscal year cost associated with each tax credit under current law from the Tax Expenditure Report published by the Department of Revenue. The cost under current law was divided by the estimated total cost of the credit as enhanced by the federal legislation. Last, the ratio derived was multiplied by the credit percentage under current law and the product was compared to the credit percentage in the proposed bill.

The bill decouples from four other provisions for the 2013 tax year, but conforms to these provisions for the 2012 tax year. The bill requires taxpayers to include 100% of the deduction or income exclusion taken for federal tax purposes in calculating North Carolina taxable income. Therefore, there is no fiscal impact associated with the decoupling from these provisions.

- Education expense deduction for tuition
- Income exclusion for discharge of residence indebtedness
- Premiums for mortgage insurance deductible as mortgage interest
- Tax free distribution from IRAs to charity for individuals age 70.5 or older

The chart on the following page summarizes the effective dates for decoupling or conformity to specific federal provisions grouped by business-related provisions and individual-related provisions, and shows the two-year combined fiscal impact.

| Federal Provision | Decouple/Conform (\$Millions) | | Cost to Conform | | 2 FY Total |
|--|----------------------------------|-------------------|-----------------|---------|------------|
| | For tax year 2012 | For tax year 2013 | FY12-13 | FY13-14 | |
| BUSINESS-RELATED PROVISIONS | | | | | |
| Bonus Depreciation | (No 2012 law change) | Decouple | 0 | 0 | 0 |
| Enhanced Section 179 Expensing | Decouple | Decouple | 0 | 0 | 0 |
| 15-year depreciation schedule for leasehold, restaurant, and retail property | Conform | Conform | -2 | -3 | -5 |
| Work Opportunity Tax Credit | Conform | Conform & Adjust | -1 | 0 | -1 |
| INDIVIDUAL-RELATED PROVISIONS | | | | | |
| Limitation on Itemized Deductions | (No 2012 law change) | Conform | -1 | -3 | -4 |
| Education-Related Expenses | | | | | |
| • <i>Qualified Tuition & Expenses Deduction</i> | Conform | Decouple | -3 | 0 | -3 |
| • <i>Student Loan Interest Deduction</i> | Conform | Conform | -3 | -6 | -9 |
| • <i>Income Exclusion for Employer-Provided Education Assistance</i> | Conform | Conform | -3 | -6 | -9 |
| Residence-related Benefits | | | | | |
| • <i>Mortgage Insurance premium as interest</i> | Conform | Decouple | -5 | 0 | -5 |
| • <i>Income exclusion for discharge of residence indebtedness</i> | (No 2012 law change) | Decouple | -2 | 0 | -2 |
| Tax-free distribution from IRAs to charity/age 70.5 or older | Conform | Decouple | -4 | 0 | -4 |
| Earned Income Tax Credit | (No 2012 law change) | Conform & Adjust | 0 | 0 | 0 |
| Adoption Tax Credit | (No 2012 law change) | Conform & Adjust | 0 | 0 | 0 |
| | | | \$-24 | \$-18 | \$-42 |

SOURCES OF DATA: NC Department of Revenue, US Joint Committee on Taxation

TECHNICAL CONSIDERATIONS: None

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